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FM AMEMBASSY BANGKOK
TO RUEHC/SECSTATE WASHDC IMMEDIATE 3611
INFO RUCPDOC/DEPT OF COMMERCE WASHINGTON DC IMMEDIATE
RUEATRS/DEPT OF TREASURY WASHINGTON DC IMMEDIATE
RUCNASE/ASEAN MEMBER COLLECTIVE PRIORITY
RUEHBJ/AMEMBASSY BEIJING PRIORITY 3410
RUEHKO/AMEMBASSY TOKYO PRIORITY 8672
RUEHCHI/AMCONSUL CHIANG MAI PRIORITY 2875

UNCLAS SECTION 01 OF 02 BANGKOK 007577

SIPDIS

SENSITIVE
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STATE FOR EAP/MLS AND EB
TREASURY FOR OASIA
COMMERCE FOR EAP/MAC/OKSA
STATE PASS USTR FOR BWEISEL
STATE PASS TO FEDERAL RESERVE SAN FRANCISCO FOR DAN FINEMAN
STATE PASS TO FEDERAL RESERVE NEW YORK FOR MATT HILDENBRANDT

E.O. 12958: N/A

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SUBJECT: THAILAND CAPITAL CONTROLS: EQUITIES, CURRENCY VOLATILITY SUBSIDES

REF: BANGKOK 7550 AND PREVIOUS

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¶1. (SBU) The Stock Exchange of Thailand composite index rose close to 0.5 percent during the December 22 trading session. For the week, the SET is down about 6 percent. The Thai baht closed very slightly weaker against the dollar. Many traders think the worst of the market volatility (prompted by the Bank of Thailand's December 18 decision to impose capital controls) is over.

Deputy PM/Finance Minister Defends Action

¶2. (SBU) Deputy Prime Minister and Finance Minister Pridiyathorn Devakula defended his actions before the National Legislative Assembly. Basically, the DPM argued that the action was necessary to save Thailand from a collapse in exports as the baht continued to strengthen. The capital controls, he noted, have in fact stopped the one-way trajectory of the baht and even weakened the currency somewhat. While unfortunate, the stock market crash was a necessary price to save the country. "Don't say this (the stock market crash) is the price we pay for being stupid. Once we saw a problem, we moved to address it. The measure was meant to end the export crisis. I have told them (the critics of the DPM's action) to look both ways -- also to alleviate the problems. Nothing was underhanded. It's alright if I am disgraced in this matter as long as the country survives."

Was BoT's Independence Respected?

¶3. (SBU) Questions continue to be raised over the way the capital controls decision was made. In response to charges that he usurped the proper role of the Bank of Thailand and undermined its independence, Pridiyathorn replied that the decision to impose capital controls was made two weeks ago by the BoT in full consultation with him and Thai stock exchange officials. He conceded that the December 19 decision to partially lift the controls by exempting the stock market was made without the head of the BoT being physically present, but this was because Governor Tarisa was in the northern Thai city of Chiang Mai (Embassy Comment: We are told that Tarisa

was on vacation) and couldn't return until Wednesday morning (December 20). That, Pridiyathorn said, "Would have been too late." He added that Tarisa was in touch by telephone and that she fully concurred in the decision to exempt stocks. Stock exchange officials, he said, had not been fully informed of the BoT's plans due to fears of leaks.

Comment

¶4. (SBU) The BoT Governor rightly points out that the underlying problem with Thailand's export competitiveness is the rapidly developing Chinese economy and its undervalued currency. But there is an even deeper problem at work. Pridiyathorn is not engaging in hyperbole when he claims that the country's exports were threatened with collapse. At baht35/US\$1 (the approximate rate which triggered the imposition of capital controls), we believe a large percentage of Thai exports were unprofitable (i.e., many Thai exports are commodities, and generally are price takers in their end markets). That a fairly modest strengthening of the baht relative to Thailand's competitors could threaten the viability of Thailand's exports and its entire economy attests to the fragility of that economy. The reality -- recognized by many Thai economists -- is that in a head-on competition with China, Thailand is sure to lose. In order for Thailand's economy to continue to grow, the economy must reduce the proportion of imported components, phase out assembly-only operations of cheap consumer goods, and move up the value-added chain. That way, Thailand will not compete directly with China's exports and will avoid downward pressure on the Thai currency and wages. The Thaksin government, for all its flaws, explicitly recognized the need to address this issue through education and infrastructure development (although its record in terms of concrete accomplishments toward addressing this issue is meager). We see no evidence that the current government is doing anything

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to address this issue. Indeed, we see no evidence that it sees head-on export competition with China as anything more than a problem related to Chinese currency manipulation.

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